Share Repurchases: An Understanding in the context of Indian Capital Market

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Abstract: *The concept of the Share buyback in India was introduced in the late 20th centaury. When Indian Capital market was facing a very turbulent phase. it came concurrently with the buyback in other emerging Markets. It is a procedure under which companies to go back to its existing shareholders and offers to purchase from them the shares they hold of that company. And by this companies are going to improve their capital structure and financial performance in the capital and financial market. So how this all the techniques of share repurchases works practically is the main objective of the study and hence the researcher has given a title to the topic "Conceptual Understanding of Share Repurchases in India". The study covers mainly basic understanding of share repurchase policy with its main objectives and the different methods applicable to it. In additions to it study even includes the Procedure and Compliance Norms framed by SEBI under SEBI Regulation, 1998 accompanied with Provisions prescribed in companies Act 2013 for share repurchases.*

Key Words: *Share, Capital market, financial market, SEBI,*

1. INTRODUCTION:

Buy back is a corporate action wherein companies will buyback their shares from existing shareholders normally at a price more than its Market value. Originally this concept of share repurchases started first in US 1960, followed by Canada 1980 and then everywhere gradually. The First buyback offer in India was made in March 1999. Till 2001 it was not much in practice due to stringent rules, but later some relaxation made in complying norms in 2001 and it has stimulated as corporate restructuring action among the Indian corporate as a strategic financial management tool. Many studies are carried with the objectives of share buyback Viz**., Signaling information hypothesis** and **excess Free cash flows hypothesis** (Vermallen 1981,1984; Nohel and Tarhan,1998, Jagannathan & Stephens ;2003, **Christopher Gan** , **Chao Bian** ,**Damon Wu** , **David A. Cohen** ; 2017, Bourdy; 2013)**Capital Structure Corrections, leverage hypothesis** (Armen Hovakimian 2004,kristinna Minnick 2006, Bagwell and Shoven, 1988; Dittmar, 2000; and Mitchell and Dharmawan, 2007. Titman et al. (2001) **Substitution Hypothesis** (Dittmar; 2000, Grullon and Michely; 2002, and Skinner; 2008) **Undervaluation hypothesis** (Andreas Simon; 2008) **Stock Option Hypothesis (**Skinner;2003, Kahle;2002)Takeover deterrence hypothesis(Sinha; 1991, Bagwell;1991)**Ownership Concentration**(Andriosopoulos and Hoque;2013) **Corporate Governance hypothesis**(Lee et al.(2007),Yarram (2014), Dr. Chandra Shekar Mishra (2016))

In this paper the researcher has tried to focus on how practically the buyback procedure works and what different rules and regulations companies are required to adhered to. The Principle act responsible for share buyback was Companies act 1956.As per the section 77 of the companies act 1956 companies were restricted to purchase some shares. Companies were only allowed to repurchase their shares under the section 100 and 402 of the companies' act 1956. In 1999 some amendments were made in companies act and which allowed Indian companies to go for the buyback of shares with the retrospective effect 1998. Here three sections were introduce in the companies act 1956 related to share repurchases which are section 77A,77AA & 77B.Which is being brief out in further section. In the year 2013 all companies listed by shares has to obliged to the new act came in to force i.e., The Companies Act 2013. Section 68,69 & 70 deals with it which is discussed in detail in next section. More over in India companies are Majoritily following two methods for share repurchases. 1. Open Market Method & 2.Tender Offer Share repurchases. This is discussed in detail further.

The remainder of the paper is followed by Section II. Literature review Section III Research Methodology Section IV Methods of share repurchases prevalent in India. Section V Procedure and compliance of share repurchases Section VI Conclusion

2. LITERATURE REVIEW:

There are many Motives behind share repurchases. Under this sections researcher has presented certain literature on share repurchases by corporate firms.

As per the article presented by Dennis Oswald and Steven Young(August, November 2000) Firms are repurchasing their shares usually for the distribution of **excess cash** and to give **signaling impact to the market regarding undervaluation of shares** of the company. By analyzing 429 **Open Market repurchasing** they have even concluded that surplus cash effect is more pronounced for the firms which are characterized by **low leverage** and **less investment opportunity set.** (Young, 2002)

According to Dmitris Andriosopoulos, and Hafiz Hoque(2010)worked on certain characteristics associated with the decisions to announce the share repurchases and found that **Size, Cash dividend and Ownership Concentration consistently have a significant impact** on share repurchases. This study even supports the leverage hypothesis of the firm. (Dimitris Andriosopoulosa, 2010)

As per the Andreas Simon (2008)study on 970 open market repurchases with on-Market buyback activity found that **Dividend Substitution** intended to influence dividend buyback. Further more firms will go for buyback of those shares which are citing **under-valuation, capital restructuring and liquidity.** Mr.Sarthak Kumar Jena(2016) article on Share Repurchases: Literature Review has mentioned that till 2014-15 in india there is all in all 305 share repurchases. Out of total 305 share repurchases 162 has purchased just once and 46% has gone for more than once. Study even shows industry wise classification of shares and it has pointed that IT Industry is topping and followed by Pharmaceutical.Mainly Indian shares are categorized as under two methods.1) Tender offer (83) and stock exchanges (220) (Simon, 2008)

"Open Market V/s Tender Offer Share Repurchases"-A Conditional Event Study by Kai Li and William McNally (June -1999) mentioned that firms with **higher cash flows**, **Poorer investment opportunities, and larger insider shareholdings are more likely to make Tender offer**. Whereas **Open Market share repurchases are more likely to take place in times of market turbulence or weak business conditions**. Firms are considering their comparative advantage in their choice of repurchase programme. Ricky W.Scott, Donald R. Tapia (August,2014) focuses on **Information asymmetry and institutional investors desire to repurchases.** Rim EI Houcine(2013) pointed that there is a positive relationship between the stockholding of the managers and repurchases. (Kai Li, 1999)

R.L.Hyderabad IIM Indore (July-September, 2009) Shows that as per sebi status report, 2008 total buyback announcement 149; Open Market-87 and Fixed Price Tender offers-29.Moreover market reacted positively at 7.6% CAR under OMR method as compare to FPT of 4.96%. for subsequent buyback programme FPT is outperforming OMR with 11.6% CAR. (R.L.Hyderabad, 2009)

3. RESEARCH METHODOLOGY:

The type of the research is a Conceptual research. The information pertaining to the topic collected from the secondary sources viz., Books, Magazines, Research articles in journals, various websites etc. The main objective of the paper is to get aware about procedure of share repurchases methods and to get the knowledge about laws pertaining to buyback of shares in India as per SEBI Buyback regulation Act 1998 with amendment made in 1999 and the new and old companies Act provisions for buyback .

4. METHODS OF SHARE REPURCHASES IN INDIA:

In India there are first two common methods applicable for share repurchases i.e.,

<u>(1.) From the existing security holders on a proportionate basis through the **Tender offer:**</u>

Shareholders may be presented with this offer to submit a portion or all of their shares within a time frame. The size and price is fixed by the company always @ a Premium.

Procedure:

Step:1 Approval from shareholders by passing a special resolution and notice will contain information on: Price, No. of Shares & Promoters holding.

Step:2 A Company has to file within 7 days special resolution with SEBI & Concerned stock exchanges where the shares of the company are listed.

Step:3 Nominate Compliance officer and investor service center

Step:4 Make Public announcement and select the record date with merchant banker.

Step:5 File with SEBI within 7 days draft Letter of Offer.

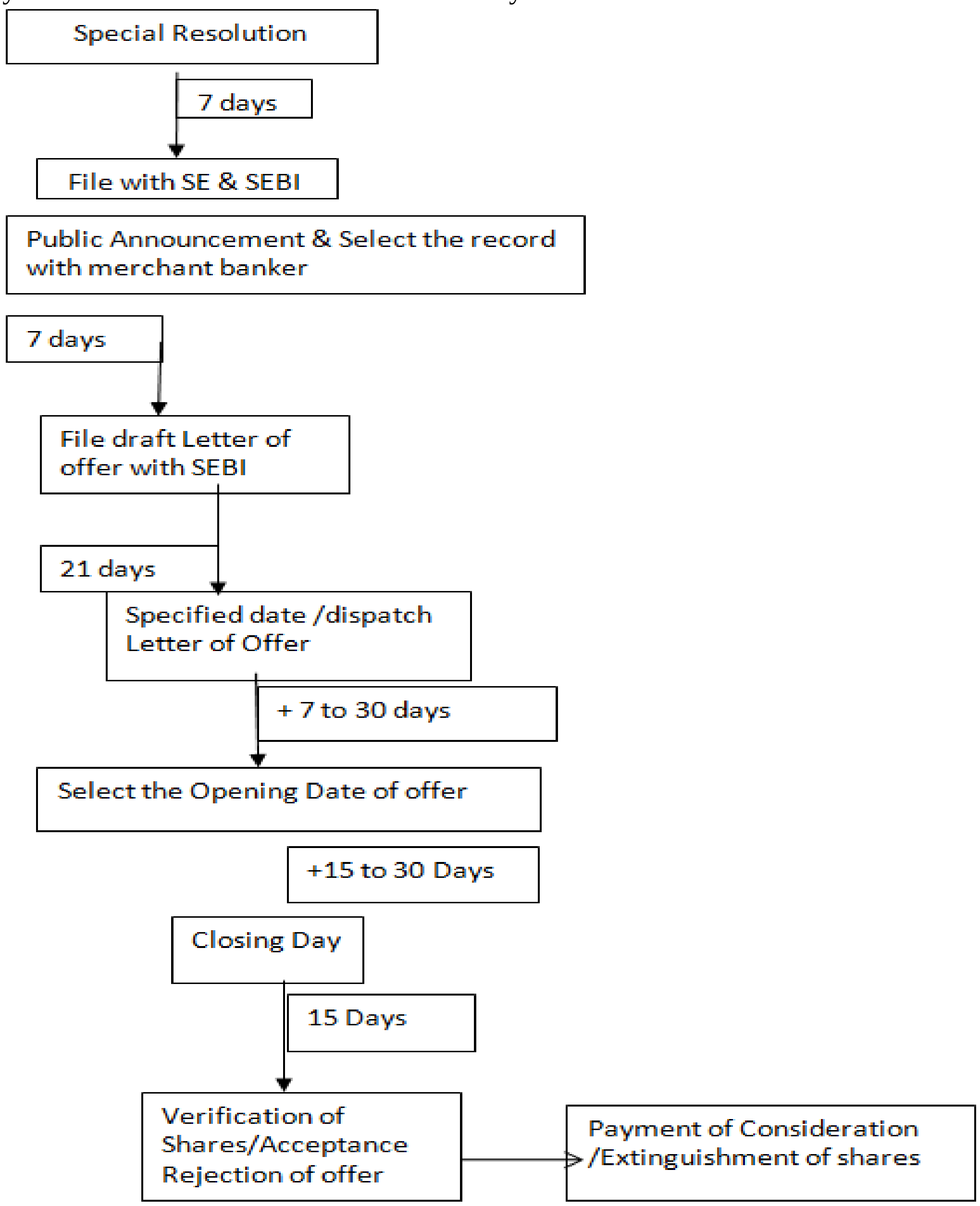
Step:6 Select the specified date/Dispatch Letter of Offer to public with 21days from the date of filing with SEBI

Step:7 Select the Opening date of offer i.e., shouldn't be earlier than 7 days or later than 30 days after the specified date.

Step:8 Deposit in an escrow account a sum equal to the 50% of share buyback

Step:9 Offer Should remain open for at least 15 days but not more than 30 days.

Step: 10Verify the offers received and communicate acceptance and rejection within 15 days of the closure of offer.
Step: 11Make payment to the shareholders whose offer for buyback has been from date of verification sent.



<u>(2) From the Open market through i) Book building Process ii) Stock Exchange:</u> In this method of share buyback, the company buys its own stocks from the market. This transaction happens through company's brokers. This repurchase program happens for an extended period of time as a large block of shares needs to be bought. The company is under no obligation to conduct the repurchase program after the announcement. The company has the option to cancel it. Also, it can make changes in the repurchase program according to company's situations and needs. If this method is effectively implemented, it can prove to be very Cost effective.

(Source: www.efinancemanagement .com)

<u>4.1 Book-Building process</u>: A company may buy-back its shares or other specified securities through the book-building process as provided hereunder:

(i) The Special resolution or the Board of Directors Resolution, as the case may be, shall be passed.

(ii) Disclosures, filing requirements and timelines for public announcement:

(a) The company shall appoint a merchant banker and make a public announcement as referred to in regulation 7.

(b) The disclosures in the public announcement shall also be in accordance with Schedule B.

(c) The public announcement shall be made at least seven days prior to the commencement of buy-back. & it should be filed with the BOD within the 2 days of such announcement.

(iii) Subject to the provisions of clause (a) and clause (b) of this sub-regulation, the provisions of sub-regulation (xi) of regulation 9 shall apply:

- (a) the deposit in the escrow account shall be made before the date of the public announcement
- (b) The amount to be deposited in the escrow account shall be determined with reference to the maximum price as specified in the public announcement.

(iv) The book-building process shall be made through an electronically linked transparent facility.

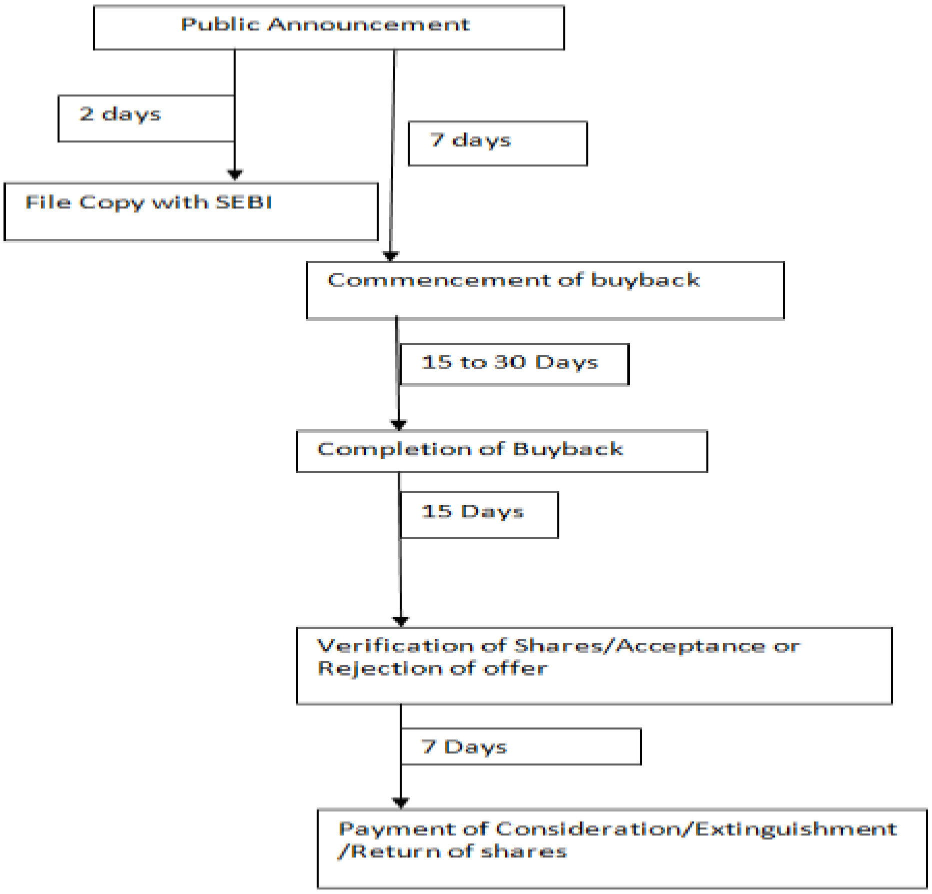
(v) The offer for buy-back shall remain open to the security-holders for a period not less than fifteen days and not exceeding thirty days.

(vi) The merchant banker and the company shall determine the buy-back price based on the acceptances received.

(vii) The final buy-back price, which shall be the highest price accepted shall be paid to all holders whose shares or other specified securities have been accepted for buy-back.

(viii) Verification of acceptances and the provisions of regulation 10 pertaining to opening of special account and payment of consideration.

(Source: www.aibi.org.in)



4.2 Stock Exchanges:

Step1: Approval from shareholders by passing a special resolution and notice will contain information on: Maximum Price, No. of Shares

Step 2: File within 7 days a copy of special resolution with SEBI and concerned Stock Exchanges where the shares of the company are listed

Step 3: File declaration of solvency with SEBI

Step 4: Nominate Compliance Officer & Investor Service Center, Appoint Merchant Banker.

Step 5: Make a Public Announcement & Submit the copy of the same to SEBI within 2 days.

Step 6: Start Commencement of buyback with in a week from public announcement.

Step 7: Furnish information to Stock Exchanges on daily basis.& Offer should remain open for at least 15 days but not more than 30 days

Step 8: Complete verification of acceptances & File the particulars of share certificates that are extinguished with stock exchanges

- **From odd-lot holders:** This method is applicable only for the holders whose are holding less than 100 shares. A Popular method which companies use to buyback stocks is called a Dutch auction. This type of offer makes it less expensive both for the company and for the shareholders.
- **Buy back of Shares for Unlisted Companies:** A Special Resolution has to be passed in the Board Meeting regarding buyback of shares and shares can be bought back on proportionate basis or by purchasing the securities issued to the employees of the company. A Company has to file Letter of Offer along with the solvency with the registrar of the companies. A Company has to dispatch the offer later immediately. Offer should remain open for at least 15 days and not more than 30 days. Company should make payment within 7days of acceptance. A Company should extinguish the certificate after this. And company should furnish a certificate to the registrar of companies duly verified by: 1. Two whole time director 2. Company Secretary. And Maintain records of cancelled shares.

5. PROCEDURE AND COMPLIANCE OF SHARE REPURCHASES:

5.1 Regulating Provisions governing Buyback of securities in India as per Companies Act 1956:

Initially there were two act governing buyback of securities in India i.e., Companies Act 1956 and the later on as amended in 1999 and SEBI Buyback of Securities Regulations, 1998. This stipulates the condition for allowing Indian Companies to buyback their own shares. The SEBI Buyback of securities (amendment) Regulations, 2012 is also introduced and brought significant changes in the guidelines regulating Indian Companies.

In India, under Section 77 of the Companies Act, 1956, no company had the power to buy its own shares unless it was by way of reduction of share capital. The law also prohibited a public company from extending any financial assistance for the purchase of its own shares. The basic reason for such a prohibition was the feeling that allowing companies to buy-back their shares could give rise to companies trafficking in their own shares leading to undesirable practices in the stock market, like insider trading or other such unhealthy influences on stock prices. This general prohibition has been diluted by statute. The Companies (Amendment) Act, 1999 (Act 21 of 1999), permits a company whether public or private, after following the prescribed procedure to buy-back its own securities with suitable safeguards specified in Sections 77-A, 77-AA and 77-B.(Source: https://taxguru.in/company-law/debating-buy-back-of-shares.html)

5.1.1 Section 77A: Power of Company to purchase its own securities.

Introduction: Before the introduction of Section 77-A, the only manner in which a company could have bought back its shares was by following the procedure set out under Sections 100-104 and Section 391 of the Companies Act which required the calling of separate meeting for each class of shareholders and creditors as well as (if required by the court) the drawing up of a list of creditors of the company and obtaining their consent to the scheme for reduction.

Section 77 essentially states that no company limited by shares, and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of capital is effected and sanctioned in pursuance of sections 100 to 104 or of section 402. Section 77 (1) by providing that a company cannot give financial assistance for the purchase of its shares. This is to ensure, at least, that those who buy shares in companies do so from their own resources and not from those of the company.

Section 77-A begins with a non-obstante clause and allows companies to repurchase their shares, notwithstanding any other provisions contained in the Act. The Section then provides for an elaborate framework to ensure that a company's right to buy-back its own shares is not abused. There is a clear demarcation of the fund from which a buy-back van be financed. Then, a buy-back exercise can be carried out only up to 25% of the paid up capital of the company and the debt to free reserves ratio should not go beyond 2:1 after such an exercise. The shares to be bought back should be fully paid. There should be authorization in the articles of the company, a declaration of solvency and finally the whole process has to be authorized by a special resolution of a company at its general meetings so as to ensure shareholder protection. The buy-back should also be in accordance with SEBI guidelines which include daily advertisements, disclosure of purchases daily, declaration by promoters of the upfront pre and post buy-back holding in order to prevent manipulation, etc**. (https://taxguru.in/company-law/debating-buy-back-of-shares.html)**

5.1.2 Section 77B: Prohibition of buyback in certain circumstances

Section 77B provides that a company shall not, directly or indirectly purchase its own shares or other specified securities—

i. Through any subsidiary company including its own subsidiary companies; or

ii. Through any investment company or group of investment companies; or

iii. If a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

iv. In case such company has not complied with the provisions of sections 159, 207 and 211. I.e defaulted in filing annual return, defaulted in distributing dividends within thirty days of its declaration and default in filing profit and loss account and balance sheet with the Registrar of Companies. (**Source:http://cacscorporatelaw.blogspot.com/2012/08/buy-back-and-companies-act-1956.html)**

5.1.3 Section 77AA: Transfer of certain sums to CRR

In terms of section 77AA, where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account referred to in clause (d) of the proviso sub-section (1) of section 80 and details of such transfer shall be disclosed in the balance sheet.

Companies Act 2013: (Section 68, 69 & 70)

5.1.4 Section 68: It deals with Power of company to purchase its own security

The various sub sections of section 68 of Companies Act, 2013 provides the following provisions to be complied with by the company. These are explained as follows;

1. Notice of the Meeting: **Section 68(3)** The Notice of the meeting at which the special resolution is proposed to be passed should be accompanied by an explanatory statement stating :

- Full and complete disclosure of all material facts;
- the necessity for the buyback
- the class of shares or securities intended to be purchased under the buy-back
- the amount to be invested under the buy-back

Section 68(4): Completion of Buy-Back

Every buy-back must be completed within a period of one year from the date of passing of the special resolution or resolution of Board of Directors, as the case may be.

Section 68(5): Methods of Buy-Back

- From the existing shareholders or security holders on a proportionate basis;
- From the open market;
- By purchasing the securities issued to employees of the company pursuant toa scheme of stock options or sweat equity.

Section 68(6): Declaration of Solvency

Section 68(7): Physical Destruction of Securities

The company must extinguish and physically destroy the shares or securities bought back within seven days of the last date of completion of buy-back.

Section 68(8): No Further Issue

No further issue of the same kind of shares or securities within a period of six months except:

- By a way of Bonus issue or
- In the discharging of subsisting obligations such as
  1. Conversion of warrants
  2. Stock option Schemes
  3. Sweat equity or
  4. Conversion of preference shares or debentures into equity shares.

Section 68(9): Maintenance of Register of Buy-back;

Section 68(10): Filing of Return of Buy-back;

5.5 Section 69: Transfer of certain sums to CRR

When the company is buying back shares out of its free reserves, Securities Premium, then the amount equal to nominal value of shares bought back shall be transferred to CRR A/c.

5.6. Section 70: Prohibition of buyback in certain circumstances.

(a) Through any subsidiary company including its own subsidiary companies or

(b) Through any investment company or group of investment companies or

(C) if a default is made by the company in:

- The repayment of deposits accepted or interest payment thereon or
- Redemption of debentures or preference shares or
- Payment of dividend to any shareholders or
- Repayment of any term loan or interest payable thereon to any financial institution or banking company.

The **Section 70(2**) provides that a company cannot purchase its own shares or other specified securities in the case of non-compliance with the provisions of sections 92,123,127 and 129.

6. CONCLUSION:

Share repurchases programme is an integral part of the company's capital allocation process, one in which management weighs reinvestment opportunities not only against the cash dividend but also both of those alternatives against a third, a buyback of common stock. Buyback can be done with more than one method but, in India two methods OMR & FPT are in use. And majority of the companies are using OMR. Actually this concept of rewarding shareholder is not yet much popular in India as compared to other countries, lead by USA in international Corporate Capital Market. Indian capital market is in stepping stones to familiarize this strategic move. However in India this concept begins in 1999, with some amendments in old companies Act 1956 & SEBI Buyback of Securities Regulation Act, 1998 and recently governed by Companies Act 2013.The limit for buyback as companies act given is not more than 15% of total capital and reserves of the companies. But recently SEBI is going to announce some amendments in this limit and ceiling will be increased to 25% of total capital and free reserves of the company. Many studies reveal that buyback of shares is primarily with the objective of improving shareholding pattern of promoters of the company and short term gains for the investments.

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